

THE IMPACT OF OWNERSHIP STRUCTURE ON STOCK RETURNS VOLATILITY

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Abstract

This study focus on the subject of corporate ownership, which have a significant impact on important corporate decisions. This study examined the effect of different type of ownership structure such as institutional ownership, managerial ownership, individual ownership, blockholder ownership and foreign ownership on stock returns volatility of listed firms in KSE. In this study stock return volatility is considered as dependent variable while the ownership structure variables and control variables were considered as independent variables. The empirical analysis of this research on the randomly selected sample of eighty firms for the period of six years starting from 2005 to 2011 from Karachi Stock Exchange 100-index. Regression analysis has been used in order to investigate the relationship of each type of ownership structure with the stock return volatility. The empirical results of the study suggested a negative relationship between managerial share ownership and stock returns volatility. The results further suggest that those firms whose greater percentage of stocks are held by their block holders may have less stock returns volatility. Furthermore results suggested that foreign ownership has also negative relationship with stock returns volatility.

Keywords: Corporate Governance, Stock Returns Volatility, Managerial Share Ownership, Foreign Share Ownership, and Block Holder Share Ownership.

Introduction

1.1 Introduction and Background

The origin of ownership structures of corporations are linked to the Adam Smith, *The Wealth of Nations* (1776). Ownership structure can be defined as distribution of shares with voting power and capital. The corporate ownership structures are of great

importance in corporate governance system of different countries because these structures actually determine the different incentives and allowances managers and effectiveness and efficiency of the modern corporations they manage.

The concept of ownership structures of corporations in the world is around two approaches that is perspective of shareholders and perspective of stakeholders. The stakeholder perspective scope is broader than shareholder perspective in the sense that stakeholder perspective proponents argued that corporations must operate in the interest of shareholders in addition to key stakeholder's interest of the firm, while shareholder perspective keep care of the interest of the shareholders only. This difference of in both perspectives leads to different results which are not only confined to the basic objective of the firm but also to differences in system of corporate governance system within the organization, ownership structure, corporate bodies etc. the ownership structure scenario arises with the incorporation of modern corporation in which ownership and control of firms lies in different hands.

This thing is first noticed by Berle and Mean (1932). Ownership structure is based on fractionated ownership. The first theory that is classical corporate finance theory which was presented by Modigliani and Miller (1958) in which they simply divide capital into debt and equity. Furthermore they did not provide the decomposition of ownership structure. After Modigliani and Miller, Jensen and Meckling (1970) came with ownership structure theory, in which they argued that ownership structure can be defined by three things that are internal equity, external equity and debts. They also did not come with the decomposition of ownership structure but made slight modification to classical corporate finance theory by dividing equity into two parts. The ownership structure changes came into existence with the globalization of stock markets also known as broker markets, feasible trading of stock, foreign investments and other factors which mainly includes merger and acquisition (M&A). Foreign investments mainly come from merger and acquisition which results in changes in corporate ownership structure and hence in corporate governance system.

1.2 Research Questions:

- i. What is the impact of managerial ownership (MANGR) structure on returns volatility (RV)?
- ii. What is the impact of institutional ownership (INS) structure on returns volatility (RV)?
- iii. What is the impact of individual ownership structure (INDVD) on returns volatility (RV)?
- iv. What is the impact of foreign ownership structure (FO) on returns volatility (RV)?
- v. What is the impact of block holder ownership structure (BH) on returns volatility (RV)?

1.3 Research Objectives:

- i. To investigate the impact of managerial ownership structure on returns volatility (RV).
- ii. To investigate the impact of institutional ownership structure on returns volatility (RV).
- iii. To investigate the impact of individual ownership structure on returns volatility (RV).
- iv. To investigate the impact of foreign ownership structure on returns volatility (RV).
- v. To investigate the impact of block holder ownership structure on returns volatility (RV).

Review of Literature and Theoretical Frame work

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Maher and Andersson (1999) know that corporate governance system is different across countries. It can be distinguished by ownership structure and controlling of shareholders. The two systems i.e. insider and outsider adopted by different countries. Under both systems conflicts arises between manager and shareholders, majority and minority shareholders, which affect the performance of the company which materialize in the shape of stock price volatility. Hotchkiss and Strickland (August, 2003) investigated that when firm actual earnings are below than expected; it shows a negative impact on stock price. Hotchkiss and Strickland (August, 2003) argued that ownership structure is related to stock price volatility especially in earnings announcement days. Empirical results further explain that institutional ownership has a strong and significant effect on stock prices, when the corporation information releases. Lemmon and

Lins (2003) investigated the effect of ownership structure on firm's performance. The financial crisis in East Asian countries which began in 1997 showed negative impact on firm's investment opportunities, while higher incentives for controlling shareholders which may exploit minority shareholders. The results showed that stock returns of firms with high level of control perform 10% to 20% lower than firms with low of control. Hence it is proved that ownership structure has an important impact on firm's performance and Stock Returns. Chen et al. (2003) studied the relationship between managerial ownership and firm performance. They argued that in Japan managers have very little stake in firms as compared to US. Results showed that negative significant relationship exist between firm's performance and low managerial ownership and vice versa. Therefore it is empirically investigated that with the increase in ownership, the conflicts between management and shareholders reduces. Rubin (2006) examined here that whether any link exist between liquidity of company's shares and its ownership structure. First of all it is investigated that how much shares of the company are owned by insiders and institutions and to what extent there is concentrated. The findings showed that relation between these two variables is mostly driven by institutional ownership rather than institutional holdings. Hence it was proved that liquidity is positively related to institutional ownership and vice versa. Rubin and Smith (2007) developed a research paper to find the relationship between ownership and share return volatility. They study, indeed, the effect of dividend policy on these two variables i.e. ownership and share return volatility and their relationship. It was found that correlation exist between these two depends on company's dividend policy. The results showed that institutional ownership is positively related to volatility and dividend paying shares and vice versa. Finally it is investigated that dividend policy has significant effect on Stock Returns. Aydin et al. (2007) conducted study in order to find that whether foreign owned firms are far better than national firms, quoted on Istanbul Stock Exchange, Turkey. They argued that foreign owned firms are far better than domestic firms in Turkey in respect of Return on Assets (ROAs). They also found that foreign ownership have positively related to firm performance, which means that foreign participation positively effects profitability performance of the firms at ISE. Desender et al. (2008) empirically studied that whether Stock Returns are affected by ownership structure or not. The findings of research showed that both type of ownership whether it is insider or concentrated affect stock price performance. Stock prices are positively correlated to insider ownership and negatively to concentrated ownership.

Corporate governance came into existence in order to reduce conflicts, based on agency theory, between controllers of and residual claimants of the firm. Corporate governance is a mechanism which is used to align controller's goals with those of stakeholders, which is to maximize shareholder's wealth. Chaghadari (2011) argued that independency, board size and ownership structure have no significant effect on firm's performance. However, negative relationship of firm's performance with CEO duality. Nazir et al. (2010) investigated the corporate dividend policy issue in corporate finance. Nazir et al. (2010) developed this research paper in order to examine dividend policy role in determining stock price volatility. Empirical results showed that a strong and significant relationship exist between dividend policy and stock price volatility. These findings are consistent with the earlier research of Rashid and Rahman (2008) citation down. Ongore (March, 2011) studied the effect of ownership structure on firm's performance of the listed companies in Kenya. Ongore (March, 2011) investigated that highly significant negative relationship existence of concentrated ownership and government ownership with firm's performance, while positive and significant relationship exist with foreign ownership, diffuse ownership, corporation ownership and managerial ownership. Ongore et al. (2011) also argued that a significant positive relationship exist between managerial ownership (insider) and firm's performance.

2. Theoretical Frame work

Figure: 1

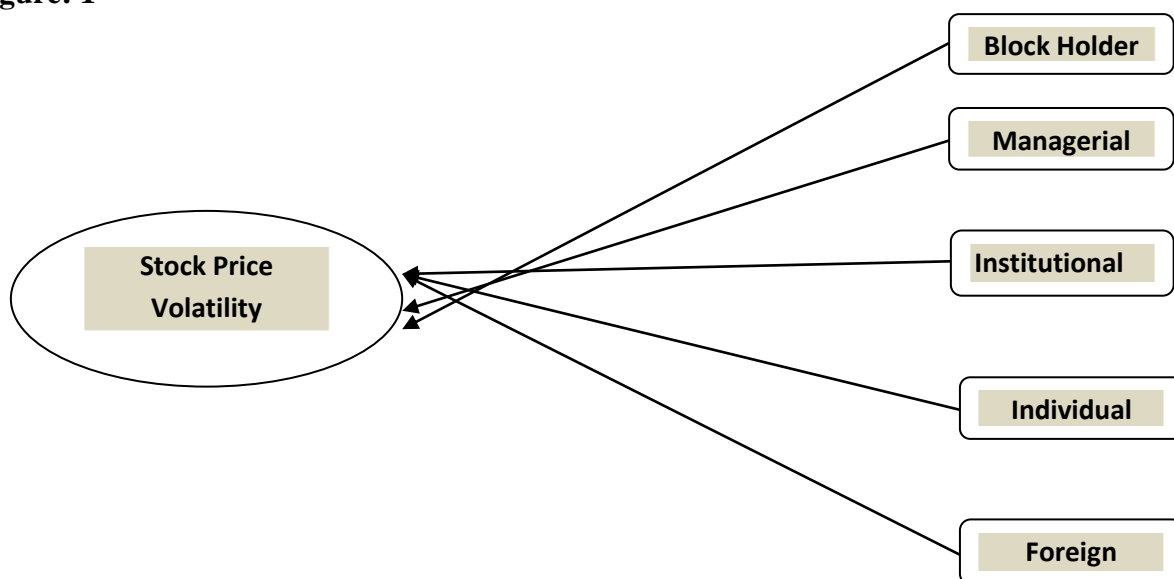


Figure 1 shows the impact of ownership structure on Stock Returns volatility in diagram form. It gives a very clear picture of the nature of the variables. On left side, Stock Returns volatility, is the dependent variable in the research study while on the right side, ownership structure, is the independent variable in the research study. As we know that the ownership structure is the compound variable that's why we categorize it into the above different form of ownership structure.

3. Research Designed and Methodology

3.1 Population:

This refers to the companies from which we are going to take data for analysis purpose. The population consists of different companies taken from different sectors which are listed at KSE-100 index of Islamic Republic of Pakistan.

3.2 Sample Size:

Sample consists of more than 75 companies which are selected from different sectors mainly includes textile, oil & gas, cement, telecommunication, food producers etc. The sample primarily includes firms of non-financial nature because financial structure of financial firms is relatively different from non-financial firms. Then in each sector those firms have been selected in the sample for which data is available for the same duration. It means availability and same duration data, are the main factors, in selecting firms from different sectors. The data collected for those firms from 2005 to 2011.

3.3 Data Collection Sources:

Data has been collected for this research from individual firm website and KSE analysis reports which are available on website of KSE.

3.4 Statistical Tools & Techniques:

In this research study different statistical tools and techniques have been used some major of them are mean, standard deviation, kurtosis, regression and correlation.

- i. Regression Analysis
- ii. Correlation Analysis
- iii. Descriptive Statistics

3.5 Model : Stock Returns Volatility, Institutional ownership, Managerial Ownership, Individual Ownership, Foreign Ownership and Block Holder Ownership

$$\begin{aligned} RVe = & \lambda_0 + \lambda_1 INS_i + \lambda_2 MANGR_i + \lambda_3 INDVD_i + \lambda_4 FO_i \\ & + \lambda_5 BH_i + \lambda_6 FS_i + \lambda_7 FG_i + \lambda_8 FPR + \lambda_9 TANG + \\ & \lambda_{10} NONDEBT\xi_i \end{aligned}$$

The purpose of above multiple and step wise regression analysis is to check the significance of each variable thoroughly.

3.6 Controlling Variables:

In this research study we took two control variables i.e. firm size (**FS**), firm growth (**FG**), tangibility of assets (**TANG**) and firm profitability (**FPR**).

For the estimation of the size of the firm we use different indexes such as firm's total assets, number of employees and market value of the firm. For estimation of firm size in this research we use the last index. In the same way different methods are used for estimation of trading volume of firm such as trading numbers, share traded numbers and trade value. We use the last one i.e. trade value for the estimation of volume of trade. (Sabri 2008).

3.7 Definitions of Variables:

Variables of research study defined as follows in the context of literature review:

i. Institutional Ownership:

The amount of institutional ownership is equal to the shares held by large block holders in the company. Large block holders in the companies are institutional investors. Institutional investors actually own at least 5% of ownership in the company's total equity. It is denoted by the symbol "INS".

H1: *There is a significant relationship between institutional ownership and Stock Returns volatility*

ii. Managerial Share Ownership:

In this research study managerial ownership mean the amount of ownership held by the board of directors, executives, management and their families in the total share capital of the firm. It is denoted by the symbol "MANGR".

H2: *There is a significant relationship between managerial ownership and Stock Returns volatility*

iii. Individual Ownership:

As the name suggests that portion of ownership held by individuals in a firm for which "INDVD" symbol is used.

H3: *There is a significant relationship between individual ownership and Stock Returns volatility*

iv. Foreign Ownership:

The portion of ownership held by foreign investors in the total share capital of the firm. It is denoted by "FO" in this research study.

H4: *There is a significant relationship between foreign ownership and Stock Returns volatility*

v. Block Holder Ownership:

The portion of ownership held by block holders in the total share capital of the firm. Block holders Ownership is equal to the sum of the percentage of ownership held by block holders in a company for which “BH” symbol is used.

H5: There is a significant relationship between block holder ownership and Stock Returns volatility

vi. Firm Size:

In our concerned research study firm size refers to the market value of the firm, denoted by “FS”.

4. Empirical Analysis

The analysis section of the research study consists of the descriptive statistics of the variables considered in the study, the Pearson correlation analysis of different form ownership structure and control variables which were considered in the analysis along with the independent variable which is ownership structure categorized into five form that are managerial, foreign, institutional, individual and block holder form of ownership and the last section includes the multiple regression analysis of all the variables considered in this research study.

4.1 Table Descriptive Statistics

Panel A: Ownership Structure Variables

VARIABLES	OBS	MEAN	STD. DEV.	MINI	MAX
MANGR	480	0.1621458	0.2156229	0	0.92
INDVD	479	.2546286	0.183275	0	0.896
FO	480	.0551521	0.1488226	0	0.96
INS	479	.2319332	0.1998437	0	0.967
BH	480	.5924792	0.2475101	0	0.996

Panel A of Table 5.1 shows the descriptive statistics of different forms of ownership structure. shows the ownership variables where MANGR stands for managerial ownership, INDVD for individual ownership, INS for institutional ownership. FO for foreign ownership and BH for block holder ownership. The third column of the panel A shows the means, fourth column shows standard deviation, fifth column shows minimum value of each type of ownership structure while sixth column shows the maximum values of each type of ownership structure.

Panel B Financial Variables

Return	479	-0.96789	0.5213053	-2.158	1.594
FS	480	3.63321	1.09165	1.0828	9.7761
FPR	480	.1349346	0.2072085	-.2775	2.1279
FG	479	.2020173	0.8067032	-.9962	14.145
NONDEBT	480	.0342863	0.0205668	0	0.1016
TANG	480	.4635815	0.2365946	0	0.9265

Panel B of the table 5.1 shows the descriptive statistics of financial variables used in the study such as Return firm size, firm profitability, firm growth, non debt and tangibility of assets. In table variables are showed by symbols given by the researcher for this study. Where FS stands for firm size, FPR for firm profitability, FG for firm growth, TANG for tangibility and NONDEBT stands for non debt standard. The descriptive statistics includes mean, standard deviation, minimum value and maximum value of each control variable.

Table 4.2 Pearson Correlation

	RV	MANGR	INDVD	INS	BH	FS	FPR	FG	TANG
RV	1.000								
MANGR	-0.0174	1.000							
INDVD	0.0192	0.2392	1.000						
INS	0.0741	-0.2762	-0.1718	1.000					
BH	-0.1652	-0.0561	-0.4100	-0.0536	1.000				
FS	-0.1550	-0.1003	-0.0850	0.1182	0.0420	1.000			
FPR	0.1183	0.0353	-0.0873	-0.0327	-0.0085	0.1168	1.000		
FG	-0.0700	-0.0155	-0.0322	0.0924	0.0330	0.2017	-0.0268	1.000	
TANG	0.0875	-0.1438	0.0479	0.1201	-0.0490	-0.0995	-0.1706	-0.0310	1.000

Table 4.2 shows the correlation between the variables used in the research study. Where MANGR stands for managerial ownership, INDVD for individual ownership, INS for institutional ownership. FO for foreign ownership and BH for block holder ownership. Financial variables such as Return, FS stands for firm size, FPR for firm profitability, FG for firm growth, TANG for tangibility and NONDEBT stands for non debt standard. The negative signs values

show the negative correlation while positive values show positive correlation. Correlation values lies between -1 and +1. These two values are the extremes of correlation magnitude. While correlation value "0" no correlation between the variables under consideration. The correlation value lies between 0 and +/-0.40 shows low correlation between variables, while between +/-0.39 and +/- 0.60 shows medium correlation, while between +/-0.60 and +/-1 shows high correlation between variables under consideration.

4.3 Pearson Correlation

The correlation table shows the degree of linear association between the different variables consider under the analysis. It shows the strength as well as direction of the association between the variables. The correlation coefficient value (r) between the returns volatility (RV) and MANGR is **-0.0174** which represent negative association between the returns volatility and managerial ownership. This implies that if the managerial ownership is increasing the return volatility decreases by **0.0174**.

The correlation values between the returns volatility (RV) and INDVD is **0.0192**, which shows positive correlation between variables which are returns volatility (RV) and individual share ownership structure. The value implies that any variation in individual share ownership will associated with returns volatility by **0.0192**. But the variation will be in the same direction; however value implies low positive correlation between variables.

The correlation values between the returns volatility (RV) and institutional share ownership structure is **0.0741** which also shows positive correlation between institutional ownership and returns volatility. The higher the institutional ownership the higher will be the returns volatility, however correlation is very between variables. The correlation coefficient between block holder ownership and returns volatility is **-0.1652** which represents negative relationship between variables, means with the increase in **BH ownership** the returns volatility will be decreases by **0.1652**. However correlation is very weak between considered variables. The correlation values between the returns volatility (RV) and firm size is **-0.1550** which implies negative correlation between returns volatility and firm size. By expanding firm size, return volatility will be decreases by **0.1550**. The correlation coefficient between returns volatility (RV) and firm profitability is **0.1183** which implies positive correlation between firm profitability and returns

volatility. The higher the firm profitability the higher will be returns volatility. By increasing firm profitability the return volatility will also increase by **0.1183**. The correlation coefficient between returns volatility (RV) and firm growth is **-0.0700** which shows negative correlation between returns volatility and firm growth. By increasing the firm growth the returns volatility will decrease by **0.0700**. So it means that by increasing firm growth the returns volatility can decrease. The correlation value between returns volatility and tangibility is **0.0875** which implies positive correlation between returns volatility and tangibility of the firm. The higher the tangibility of the firm the higher will be the volatility of the firm's returns. By looking thoroughly at the correlation table we noticed that correlation coefficient of all variables under consideration lies between 0 and +/- **0.40** which means that correlation exists up to some extent among variables but the magnitude is very weak.

Table 4.3					REGRESSION MODEL				
Dependent variable (SPV)									
Variables		Coefficients		Std Error		t-values		P-values	
MANGR		-0.96506		0.0608218		-16.23		0.000	
INDVD		-0.0597943		0.0767538		-0.78		0.436	
INS		0.102338		0. 00653174		15.7		0.000	
BH		-0.1857152		0.055255		-3.36		0.001	
FO		-0.093561		0.0563421		-5.65		0.0065	
FS		-0.0413237		0.0116533		-3.55		0.000	
FPR		0.1966305		0.0603885		3.26		0.001	
FG		-0.0114138		0.0154954		-0.74		0.462	
TANG		0.0924495		0.053484		1.73		0.085	
Constant		0.7495533		0.0724382		10.35		0.000	
F-value				27.39					
P-value				0.000					
R-Squared				0.12					
Adjusted R-squared				0.11					
Durbin Watson				2.6					

Table 5.3 shows the outputs of ordinary least square regression analysis. The first column in the table shows the symbol representing different variables which are under consideration in the research such as MANGR stands for managerial ownership, INDVD for individual ownership, INS for institutional ownership. FO for foreign ownership and BH for block holder ownership.

Financial variables such as Return, FS stands for firm size, FPR for firm profitability, FG for firm growth, TANG for tangibility and NONDEBT stands for non debt standard. The second column in the table shows the coefficients of variables and their impact on the dependent variable. The negative sign shows the negative impact on dependent variable and vice versa. The fourth and fifth columns of table shows the significance of the relationship which was showed by the coefficients of the variables. In case contradiction exists in the results of t-value and p-value. The decision should be made on the p-value. In the lower part of the table F-value shows the significance of the model overall, R square value shows the explanatory power of the variables, Adjusted R square value also shows the explanatory power of the variables but after extraction of the abnormal values from the data and Durbin Watson value shows the time trend in the data.

4.4 Interpretation of the Results

The above table 4.3 shows the results of the regression Ordinary Least Square Method (OLS). Regression analysis is done to test for the measurement of the dependency of the dependent variable that is returns volatility on different independent variables such as ownership structure of different types and some financial variables like firm size, firm growth, and firm profitability and tangibility of assets. The coefficient of the returns volatility and the managerial share ownership is **-0.965**. This shows that there has negative impact of the firm managerial ownership on the stock return volatility. The relationship is significant as the t-calculated value (**-16.23**) is greater than the t-critical value (**-2.0**) at **5%** confidence interval. Similarly the p-value calculated (**0.000**) is less the critical value at **5%**. So the relationship is significant, keeping all other factor constant if managerial ownership is change by **1%** the stock returns volatility shall be change by **0.96%**. Thus if the firm wants to control the returns volatility then managerial ownership should be increased. It also suggested that those firms with higher managerial share ownership will have lower returns volatility. The coefficient of the individual share ownership structure and returns volatility is **0.05**. This represents the negative relationship between firm's returns volatility and individual share ownership structure. The relationship is insignificant as t-value of the coefficient is less than t-critical value[2] at **5%** confidence interval. Similarly p-value is **0.436** which is greater than **5%**. So the relationship is significant. The coefficient of institutional ownership is

0.10. This value implies the positive relationship exist between stock return volatility and institutional ownership. For the relationship significance we look at t-value and p-value. By looking at t-value of institutional ownership coefficient which is **15.7** greater than t-statistics critical values which mean that relationship is significant. While p-value which is **0.000** greater than critical p-value **5%** so p-value shows that relationship is insignificant. In order to decide whether the relationship is significant or insignificant we usually give preference to the p-value. So it is concluded that the relationship between institutional ownership and stock return volatility is insignificant. The blockholder ownership coefficient is **-0.18** which implies negative relationship between stock return volatility and block holder ownership. The relationship is significant as t-value is **3.36** which is greater than t-critical values at **5%** confidence of interval. Similarly the p value which **0.001** less than p critical value so the relationship is significant. Keeping all things constant if block holder ownership is increases by 1% stock return volatility can be decreased by 0.18%. Thus if the firm wants to control the stock return volatility then the block holder ownership should be increased. It also argued that the firm with higher block holder ownership will have minimum return volatility. The coefficient of foreign ownership is -0.09 which shows negative relationship with stock return volatility. The relationship is significant because both t and p value are significant at 5% confidence interval. As we came to know that the relationship is significant by t and p value interpretation, keeping other things constant if we increase foreign ownership by 1% stock return will be decreased by 0.09%. Thus it is suggested that if firm control stock returns volatility, foreign ownership should be increased. The coefficient of firm size is -0.04. This value shows that there is negative relationship exist between stock returns volatility and firm size. The relationship is significant as interpreted by t-value and p-value of coefficient at 5% confidence interval. Keeping other things constant if we expand firm size by 1% stock returns volatility will be decreased by 0.04%. It is also suggested that stock returns volatility can be decreased by increasing firm size. Thus if the firm want to control stock returns volatility it should increase firm size. FPR coefficient value is 0.19 which shows that positive relationship exist between stock returns volatility and firm profitability. The relationship is significant as interpreted by both t-value and P-value of the coefficient of the firm profitability. It means higher profitability firms have high returns volatility. It shows that 1% change in firm profitability will bring about 0.19 changes in returns volatility. Firm growth coefficient showed negative relationship value of which is equal to -0.01. but the relationship is

not significant t-value is less than |2| and similarly p-value of coefficient is 0.462 which is greater than 5% p-critical value. Tangibility of assets showed that positive relationship with stock returns volatility. The value of TANG coefficient is 0.09. The relationship is insignificant because both t-value and p-value showed insignificant results. Coefficient of constant is 0.74 which positive relationship with stock returns volatility. The relationship is significant because both t-value and p-value are significant according to the standard of significant results.

The F-value for the model is 27.39 which is more than 4 according to the rule of thumb therefore the overall model is significant so reject the null hypothesis of insignificant model and accept the alternative that the model is statistically significant. The adjusted R-squared or R^2 used that how much portion is explained by independent variables of the dependent variable. In our case R^2 is 12% which suggested that 12% variation in the returns volatility is explained by the managerial ownership, institutional ownership, individual ownership, foreign ownership, block holder ownership, firm size, firm growth, firm profitability, and tangibility of the assets while the Durbin Watson results suggested that there is no time trending as it is not near to 0 or 4.

Conclusion

This study focus on the subject of corporate governance which have a significant impact on important corporate decisions. This study examined the effect of different type of ownership structure such as institutional ownership, managerial ownership, individual ownership, block holder ownership and foreign ownership while controlling for variables such as firm size, firm growth, tangibility of assets and firm profitability. The research study used the data of eighty firms which were selected randomly for the period of six years starting from 2005 from the Karachi Stock Exchange KSE-100 index. In this study stock return volatility is considered as regressed variable and shareholder or ownership structure as regressor variable. Stepwise regression analysis has been used in order to investigate the relationship of each type of ownership structure thoroughly with the stock return volatility. The results of multiple regression analysis showed that managerial share ownership structure has significant relationship with stock return volatility. Similarly block holder and foreign share ownership structure showed significant negative relationship with stock returns volatility.

Thus from the empirical analysis of the research it is proved the ownership structure play very important role in stock returns volatility in addition to minimizing agency relationship problems. Managerial share ownership, foreign share ownership and block holder share ownership have negative impact on stock returns volatility. With the increase in these type of ownership structure stock returns volatility will be decreases. Managerial share ownership, foreign share ownership and block holder share ownership bring stability in returns. However in emerging economies very less legal protection given to the investors and mostly firms are directed and controlled by managers, where they did not run the firm in the interest of shareholders. So that's why the results of this research are strongly aligned with previous studies of emerging economies.

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